

Value Boosters or Dampers? Insights of Corporate Governance Practices From Pakistan

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Abstract

Rampant corporate failures have placed corporate governance in the limelight again however not all governance practices help firms in enhancing value. This empirical research examines impact of corporate governance practices on shareholders' value represented by earning per share of 243 listed firms on Pakistani Bourse. It ensued in the conclusion that overall corporate governance tends to have significant impact on earnings per share and reveals dichotomy of corporate governance practices based on direction of their association with share holders' value and terms them as value boosters and value dampers. It has also been found that pro-entrenchment practices tend to lower earnings per share in the listed firms either due to complacency or vested interests while rest of the practices help in enhancing value earned on each share thus endorsing the theoretical perspectives emanating out of agency and shareholder activism theories. This study emphasizes the significance of Board Attendance, Board Independence, Non-duality of CEO-Chairman Role for listed firms' value. It also shows that entrenchment acts like larger boards, directors' ownership, large block holders and disclosure of such ownership can adversely impact the firms' value and thus play a significant role in scaring away the potential investors who primarily look at earnings per share for buying of stocks of a particular company. It entails policy implications that implementation of counter-entrenchment regulations needs strengthening as the existing seem to have cosmetic effect. Identification and implementation of good governance practices can be best ensured when propagated in the perspective of value enhancement.

Key Words:

Agency
Theory,
Corporate
Governance,
Earning per
Share,
Entrenchment,
Shareholder
Activism.

Introduction

The word Corporate originates from Latin where the word corporatus is the past of “corporare” which means to form into a body. Similarly, “corpus” means

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“body” in Italian literature. Corporate in English means belonging to a corporation or a group of persons or a business body as such. It also means united or combined into one. Merriam Webster dictionary defines it as bonded into an association and given the right and duties of individual. The word “Governance” originated from the ancient Greek word essentially a verb “kybernein” or “kybernao” which means steering a ship or guiding and maneuvering an inland vehicle. The expression was first used by Plato to mention state governance, how men are ruled by the state. In modern English it means something related to government and “to govern” and “to run an organization, team, group, project or state”. In today’s world governance is more comprehensive than mere steering. Therefore, Corporate Governance in simple words means to run a business concern usually an incorporated firm. The draft report of Cadbury Committee defined it as,

“The system by which companies run”.

However, in the final report Secretary of Committee, Nigel Peace improved the basic definition and presented it to be as such:

Corporate Governance is the short hand expression for the system by which companies are directed and controlled; the system involves three parties, directors, shareholders and auditors -and is determined by the way in which they exercise their respective roles within the statutory framework of the companies act.

Corporate governance has become a popular research area within finance and economics. This term; corporate governance is multifaceted encompassing board of directors, executive compensation, shareholder activism, ownership structure, regulation, ownership structure, disclosure, audit and transparency. The definition of corporate governance varies with the framework being followed. International Finance Corporation states it like this,

"The relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders".

The OECD Principles of Corporate Governance has defined it differently:

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

Corporate failures like Enron and WorldCom and regional financial crisis in the recent past call for emphasizing corporate governance for efficient running of firms. In Pakistan too Mehran Bank, Taj Company and Mazarba scandals revealed weak corporate governance. It is understood that corporate governance can effect performance of firms and many studies confirm it too.

Therefore this study undertakes to investigate impact of corporate governance on firms' value.

This section is followed by significance of the study, problem statement, literature review, hypothesis developed and details of data collection. In the end description of variables, model specification & methodology, data analysis, conclusion and policy recommendations are narrated.

Objective & Significance of the Study

This empirical study answers the question that whether corporate governance impacts earnings per share. The is an attempt to investigate the inter-relationship of various governance practices and the firm value in terms of earnings per share.

Taking into account previous studies, including those conducted in Pakistan, it has been observed that Javed and Iqbal (2010) tested the effect of Corporate Governance on external financing of firms, with a too small sample of 60 companies. Azeem et al. (2013) did not test endogeneity and took only 50 companies, showing mixed results. Halili et al. (2015) compared family and non-family businesses in Australia. Abu Ghumni et al. (2015) took two variables of Corporate Governance: ownership percentage and shareholder identity in Jordan. Alam and Shah (2013) suggested that future research could be done using more Corporate Governance variables and a larger sample size. Their study abled to confirm the relationship of some governance variables with the risk specific to the company; however they did not focus on firms 'value. Most such studies in Pakistani context did not test for endogeneity which makes a call for this research. Also fewer studies focused on Earning per Share (EPS) which is keenly watched by investors and its relationship with governance is not clear. Therefore, this study attempts to determine the relationship of corporate governance and shareholders' value in terms of earnings per share by taking a larger sample and more variables of Corporate Governance with endogeneity testing of the variables.

Problem Statement

The problem under consideration is whether corporate governance contributes in shareholders' value in the firms and whether better corporate governance can help in augmenting earnings per share of the firms listed on stock exchange in Pakistan.

Literature Review

Agency theory looks at two parties having conflicting interest in the same asset. It assumes that principle /owner of a business hires an agent and delegates work to manager or an agent with the responsibility to make some work related decisions and execute the same in order to protect the interest of the principle. However as

admitted by Adam Smith, principal and agents are bound to have different interests and an agent may not necessarily work towards safeguarding the interest of principal and this is where corporate governance comes into play. During the decade of 70s, Barry M. Mitnick and Stephen A. Ross did some spade work for the formulation of agency theory. However the theory did not get its more developed form until, William H. Meckling and Michael C. Jensen came up with a broader view of the notion in 1976 by presenting their paper, which was more widely accepted than its previous versions. They explored agency costs and its sources which were not previously studied. Later in 1983, Fama and Jensen researched that agency relationship can be optimized by segregating ownership and control on decisional authority in firms. Idea of corporate governance seems to spring out from the same germ seeds of agency theory. Corporate governance today is seen as an answer to some of agency problems faced by corporation and firms. Jensen & Murphy also studied pay, incentive and penalty structures for optimum performance of management. Some codes of corporate governance like duality of Chairman and Chief Executive Officer, and having Independent Director & Non-executive Directors in board of the firm have their roots in agency theory, therefore this theory is still referred to when studying components and determinants of corporate governance.

A persistent question that has intrigued empirical researchers is the measurement of the performance, more appropriately so in the settings of the ownership formation and board composition of company. The content comprising a firm's performance is the heart of concern for management researchers as it explains any variation in performance which itself is a popular topic in organizational studies (Gentry & Shen, 2010). Organizational performance has many dimensions however its financial aspect has been the most researched one (Barney, 2002). In order to estimate financial performance the literature mainly suggests the use of measurements based on either accounting performance or market performance of a company (Hult et al, 2008). Both hold some advantages and some disadvantages as well. Demsetz and Lehn (1985) used the accounting profit rate. Demsetz and Villalonga (2001) and also Morck, Shleifer and Vishny (1988) had used market based ratios like Tobin's Q for alternatively measuring the business performance in governance studies.

The two categories mentioned above are different in time and power measurement. Most of researchers as McConnell and Servaes (1990), Loderer and Martin (1997), Cho (1998), Himmelberg, Hubbard and Palia (1999), Hermalin and Weisbach (1991) and Holdernebb, Kroszner and Sheehan (1999) preferred market based measure of financial performance. There has been lot of debate evident from literature on comparative advantages of market and accounting based measures (Richard et al., 2009). The problem with the accounting measures is that its computation is according to accounting standards that do not incorporate the market information and growth prospects like market based ratios. Moreover,

accounting measures reflect only single aspect of performance (Lubatkin & Shrieves, 1986). Similarly, measures based on accounting like return on assets or equity and retained earnings rate are inherently more backwards. Another reason to prefer market based measure is that accounting based measures are innately retrospective while market based measures are prospective in nature. It is well known that retrospective is also transient while prospective is enduring when it comes to investment analysis and decision making. (Hoskisson et al., 1998). In literature there is mixed trend of using accounting based ratios like return on asset, return on equity, net profit margin, and market based ratios like Tobin's Q, price earnings ratios and earnings per share.

Net income in simple words is the ratio which provides an estimate that how much a firm earns on each share held by shareholders or rather how much a shareholder earns on each common share held. It is employed by investors as an indication of financial excellence of the firm. In financial economics literature it has been studied for corporate governance effects by researchers. It was assumed by many of them that higher value of earning per share leads to better performance in companies. The evidences in past literature are mixed when proving the same. It has also been observed from literature that very few researches have looked into impact of corporate governance on earnings per share especially in Pakistan.

An earnings per share is the most significant of all financials indicators reported to shareholders (Jorgensen et al., 2014). Corporate governance must ensure running business well and earning a good return on share holders' money (Magdi & Nadereh, 2002). Board of directors exercise their power and hence control the behaviour of managers in increasing a firm's value (Fama & Jensen, 1983). It has been rightly said that quality of accounting ratios can be determined from the kind of corporate governance a firm tends to exercise (Sloan, 2001).

The relationship could be the other way round as well as accounting information is fed to the very corporate governance system resultantly firms are better controlled (Bushman & Smith, 2001). A high earning per share reported to shareholders can ensue in repurchase of stock by companies thereby attempting to manage share prices (Lazonick, 2014). When a corporate entity is not being governed in the right way, the investors will not invest in the firm and therefore it leads to financial distress ultimately reducing share holders' value (Waseem, Saleh & Fares, 2011). Corporate governance is a mechanism or structure available to the company and through it performance of the firm may be monitored (Kajola, 2008).

Corporate Governance components like board's composition, size, audit committee and attendance impact financial performance (Fauziah, Yusoff & Adamu, 2012). The association developed among components of corporate governance and financial performance is quite complicated and cannot be justified by one single theory of corporate governance (Fauziah, Yusoff & Adamu, 2012). Aman and Nguyen (2008) emphasized the inverse characteristic displayed in the relationship of corporate governance and corporate performance. They have

included the characteristics of supervisory boards, ownership structure, quality of information and security for investor interests in the corporate governance for Japanese companies.

Board Size

Generally, studies show that size of board can form a positive correlation with performance (Kalsie & Shrivastav, 2016). Researches reiterate that size of the board matters as it tends to influence senior managers and information is speedily processed to show better firm performance (Zahra, et al., 2000). Board size also effects disclosure level decisions. More directors help in symmetry of information (Chen & Jaggi, 2000). The importance of larger board is not a new reality, many decades older researches also stress on the advantages of a larger board (Birnbbaum, 1984). In a study on Malaysian Islamic banks' corporate governance explained 31% of variation in earnings per share and a negative relationship was found between Shariah Board size and earnings per share in Malaysian Islamic Banks (Shittu, Ahmad & Ishak, 2016).

Number of Board members is directly linked to firms' value in United States of America (Linck et al., 2008). Similar results were obtained in another research (Alimehmeti & Paletta, 2014). It was endorsed by a study that magnitude of board is linked with Malaysian firms' performance (Johl et al., 2015). Some studies however reported that Board size adversely effects Tobin's Q and market return in United Kingdom (Guest, 2009). The extensiveness of board has negative impact on earnings per share in Nigerian listed firms. (Adebayo, Olusola & Abiodun, 2013). Rarely a study reports no association among board size and earnings per share (Gherghina, 2015).

Board Composition

A board of directors usually includes all sorts of directors and is made up of executive, non-executive and independent ones. Literature survey shows that Board composition and independence tends to cast positive influence on earnings per share of the listed Nigerian firms (Adebayo, Olusola & Abiodun, 2013).

Executive Directors

Such directors are on payroll of the firm, working on a senior position. They were in majority before Cadbury reforms in 1992 however now report term them as "rare-breed". Executive directors bring value to the board and are equally contributing to achievement of the firm in the long running. Executive directors positively influence (EPS) earnings per share (Ayesha et al., 2015) in Sri Lankan firms. Executive directors are supposed to be employee and directors at the same

time which adds to their responsibility. Other directors seek inside information from them (Boumosleh & Reeb, 2005). Being sub-ordinate of CEO makes them less influential on board especially when CEO is also the chairman (Daily & Dalton, 1993). In Malaysia firms having more executive directors on board perform better on Stock Exchange (Shakir, 2008).

Non- Executive Directors

Existence of directors who are non-executive does solve agency problem to a major extent (Fama & Jensen, 1983). It brings diversity and independence to the board. A primary research conducted on Irish SME's found that non-executive directors take part in strengthening board and its performance significantly. The questions in the study were responded by respective Chief Financial Officers of the firm (Regan et al., 2005).

Independent Directors

The directors who are never on the payroll of the firm and have no fiduciary rights are independent directors. They usually are not allowed to hold shares or depend on the firm in any respect. The number of independent non-executive directors positively impacts earnings per share however casts no effect on Tobin's Q ratio (Meyer & De Wet, 2013). Board ownership has adverse impact on Tobin's Q and earnings per share ratio. (Meyer & De Wet, 2013). Similarly number of directors serving on South African firms have positive impact on earnings per share (Meyer & De Wet, 2013). Independent directors tend to cast mixed influence on Earnings per share (Alhaji, Baba & Yousoff, 2013). Similar results were shared by another research work (Abor & Adijasi, 2007). Theorists believe that independent directors make effort in improving auditing mechanism which results in better performance (Salleh et al., 2005). However tenure of directors can moderate such behavior (Conger & Lawler, 2009). An adverse association between presence of independent directors and firms' performance has been reported in Turkish listed firms (Aarat, Orbay & Yurtoglar, 2010) and found no significant nexus exists between the two business phenomena. Same results were obtained for Indian firms (Garg, 2007). However in United States negative relationship was reported (Epps & Ismail, 2009) among independence of board and discretionary accruals. Percentage of outside directors is reported to have been associated with higher performance of firms in Belgium (Dehaene et al., 2001). Affirmative relationship among board independence and composition and firms' performance in Nigeria has also been reported (Uadiale, 2010).

Separation of CEO & Chairman Roles

Jensen in 1993 opinionated that duality of role can ensue in minimization of

supervision and increase in agency costs thus giving way to possible poor financial performance. Empirical studies show mixed results on effects of chairman and CEO separation or vice versa duality on financial performance. Some countries allow for duality of the role if approval is granted by shareholders in annual meeting for example in Vietnam (Phan & Vo, 2013). More than fifteen countries 'corporate codes during 2003 recommended that CEO's and Chairman's positions should be separately filled and same should not serve for both purposes (Dahya et al., 2009) while some researchers report that 84 percent firms practice creating separation between role of chairman and CEO (Hedrick & Struggles, 2009). In order to implement the recommendations in many countries, firms have adapted themselves and ensured duality (Chen et al., 2008). It was revealed in a study that CEO-Chairman duality negatively impacts earnings per share in Nigerian listed firms (Adebayo, Olusola & Abiodun, 2013).

Board Attendance

It is believed that more frequent board meeting tend to cast a good impact on performance in the firm (Dar et al., 2011). While few older researches report adverse relationship among board members' meeting and performance in financial terms (Vafeas, 1999).

A study conducted on Colombo Stock Exchange unearthed a weak relationship among board meeting frequency and earnings per share of Sri-Lankan firms (Ayesha et al., 2015). Frequently meeting boards are positively effective for performance of firm (Johl et al, 2015). Frequency of board meetings when studied in Australian context revealed that it can accelerate the firms' performance (Hoque et al, 2013).

Ownership Concentration (Block Holders)

For American firms more than 10% block holders are 17% on average (Gugler, and Weigand, 2003). However its impact on firms' performance is said to vary with context. A research on German firms found adverse or no impact of outside block holders on performance measures and it effects positively on firms 'performance if block holders are owners of family owned companies (Andres, 2008). Therefore family block holders are more effective than outside block holders. Amir Bhidé stated in an article in 1994 that

“Outside Shareholders cannot easily distinguish between a CEO's luck and ability”.

According to some researches concentration of ownership can trigger agency conflicts in the firms owned by family (Morck & Yeung, 2003). Literature shows that effects of concentration vary with the ownership too. However, senior executive ownership was positively co-related to performance.

Inside (Directors) Ownership

Shareholders own shares which are a certain percentage of the total capital held by the firm therefore by virtue of their holding they have a financial stake and certain rights in the firm. Researches on American and German panel data of firms revealed (Gugler & Weigand, 2003) that inside ownership does effect performance of firms reflected by return on assets, however ownership is endogenously related to performance while large shareholders exogenously impact the performance.

It is believed that on average inside shareholding is thirteen percent in United States of America (Gugler & Weigand, 2003). Inside ownership may include family directors' ownership. Panel data of Taiwanese firms however showed no impact of inside ownership on firms' performance (Sheu & Yang, 2005). However if the ownership is held by senior management of the firm, it may impact performance positively. Inside ownership is considered to be an auto mechanism for corporate governance and internal control. Various studies endorsed the entrenchment hypothesis and convergence of interest. That performance increases with high levels of inside ownership and also with the low levels of the same whereas in between levels of inside ownership, the performance tends to fall thus making a U-shape non-linear trend. The same relationship exists between inside ownership and board composition (Peasnell, Pope & Young, 2003). The same has been observed in Spanish firms (Iturralde, Maseda & Arosa, 2011). Inside ownership is two edged sword for one it tends to solve agency problems by aligning the interest of shareholder and management. Secondly in more concentration it gives rise to new conflict of interests that is between majority shareholder and minority shareholder supposedly outside holder (Fama & Jensen, 1983). Michael Jensen stated in a finance journal published in 1993,

"Managers leave the exit to others while they continue to invest so that they will have a chair when the music stops".

Literature survey shows no relationship of directors ownership and growth opportunities (proxied by ratio of market to book value) for one time series while in other positive relationship among directors' ownership and market return was found. In the same study the directors' ownership casted negative impact on market returns and earnings per share for another time series for the same sample firms (Bhagat, Carey & Elson, 2009).

Institutional Investors

A devoted institutional ownership leads to privileged access of firm-specific information which inturn lead to better performance (Piotroski & Roulstone, 2003). Institutional Investors apply pressure to managers to perform on the basis of inside information (Gillan & Starks, 1999). Shareholder activism driven by institutional investors has gained popularity over time however their effects have

been addressed by very few researches until now (Gillan & Starks, 1999). Stock performance of high foreign institutional ownership was found better than in lower foreign institutional ownership among Taiwanese firms (Huang & Shiu, 2006). A simultaneous research in England and France concluded that institutional investors effect performance of initial public offerings when controlled for endogeneity (Bruton, Filatotchen, Chanhine & Wright, 2010). Some institutional investors do not veto the decisions made by firm's management as they hold business relations with the concerned firm already (Cornett, Marcus, Saunders & Tehranian, 2003). No single established association exists between institutional shareholder and firm's performance. This varies with each country and industry. Different studies have come up with different result. In Jordan the investors weakly monitor firms' performance (Al-Najjar, 2015).

Group Affiliation

A research (Yu, Ees & Lensink, 2009) on Chinese firms revealed that Group association positively impacts firms' performance although the firms are state owned but China encourages them to form groups for corporatization's sake which is Chinese alternative to privatization. Another research conducted in Pakistan (Ghani , Haroon & Ashraf , 2011) also compared financial performance of both affiliated concerns and non affiliated firms in Pakistan and found that ROA of group associated firms tends to be higher and firm size of group firms was larger too. Their comparative study was based on non-banking firms. The said research also compared the relationship before implementation of corporate governance laws in Pakistan that is 1998 for 196 firms and after issuance of code of corporate governance in 2002 for 160 firms. Researchers took into account return on assets and equity and Tobin's Q as estimates of accounting based financial performance while EPS as measure of stock performance. They concluded that group associated firm not performs only but exhibit better profitability than non-group firms and also implied that group affiliated firms play an indirect role in economic growth in the country in support of market failure argument.

Disclosure of Audit Committee

Board of directors exists in order to make sure the protection of interests of shareholders as described by agency theory. The theory doubts that unmonitored management can safeguard interests of the shareholders who also hold the ownership of the firm. Board committees are formed to oversee the management's performance. In order to divide work among board members according to their expertise Board sub committees are formed which comprise of fewer Board members and gives special attention to the relevant matters under purview. One

such committee is Board Audit Committee, through which Board delegates to oversee financial matters of the company to it (DeZoort et al, 2002).

Carcello et al., (2002) researched audit committee disclosure in NYSE listed firms and found that it was more practised in larger, depository firms with more independent committees. Existence of audit committee is said to have a positive correlation with financial disclosure (Ho & Wong, 2001) which usually result in a better performance of stocks (Mitton, 2002). Back in 1992, Forker also discussed audit committee as a monitor to decrease agency expense and enhances disclosure quality.

Research work shows that ownership structure, board of directors and its committees effect earnings management policies and therefore results in higher earnings per share which attracts and retains investors' interest (Trapp, 2009). Researchers yielded results which endorsed the idea that presence of audit committee enhances the standard and reliability of financial results (Ahmed & Henry, 2012). It was revealed in a study that BAC reduces earnings management practices and thus effects earnings per share (Trapp, 2009).

Disclosure of Share Ownership

It has come into financial literature many a times that financial crisis of 1997 was a prodigy of flawed corporate governance exhibited by the Asian firms which in turn shook the investors' confidence (Tan, 2000) and (Mitton, 2002). It is also said that in developing economies poor transparency caused information dearth and asymmetry which became the reason of a sharp fall in firms' market value (Jensen & Meckling, 1976). Lower transparency means lower level of governance. In order to improve financial performance, disclosure must be given with full details (Lobo & Zhou, 2001). Investors like to invest in securities of firms which give out full disclosure information (Mitton, 2002).

Age of the Firm

Age affects the performance of the firm therefore older firms tend to have better performance as a consequence of survival bias and also due to the effect known as learning curve (Chen, 2001). Older firms are more established and well rooted in the industry and therefore is able to enjoy economies of scale. Therefore it is essential for researchers to control the impact of age in studying the impact of corporate governance on financial and market performance (Sheu & Yang, 2005; Mayur & Saravanan, 2006).

Market Risk

It is the systematic risk which is innate in market dynamics and as such cannot be controlled however diversification is possible to some extent. Studies show that it

is related to corporate governance and effects the relationship even when found insignificant Saunders et al. (1990) discovered that inside holding can play an effective role in mitigating risk.

Development of Hypothesis

Agency theory implies that wealth maximization needs intervention of directors as managers themselves would never act in the interest of owners while fiduciary capitalist theory believes in shareholders especially institutional investors' activism which may result in increasing value. However entrenched managers and directors may not be able to look after wealth addition goal. Agency theory also believes in separation of ownership and control functions therefore chairman and CEO duality is expected to cast a positive impact on firm value.

In the light of above literature and theoretical background, we are inclined to believe that the following variables of corporate governance would impact firm's value represented by earnings per share when controlled for size and market risk. The hypothesis of the study developed is as under;

H₁: Corporate Governance Practices (BDS, BCOMP, CEOS, BAIL, F5BLOCK, F10BLOCK, DO, II, GA, BAC, SO) are associated with Earning per Share (EPS) of PSE-listed firms.

Data Collection

In current research study population includes listed non-financial firms in Pakistan. In selection of sample, stratified and judgmental random sampling design used were deemed best fitted criterion in this research. The study uses panel data of 243 PSE-Listed firms from 2009 to 2015. Time period and data breadth used for 243 chosen firms seem enough to suffice the research question and ensure reliability for the study. In order to analyze research objective, secondary data on yearly basis has been used. Data on financial value and corporate governance have been collected personally from annual reports and financials available from stock exchange, corporate offices and their official websites as well as from State Bank of Pakistan. Data on corporate governance have been extracted from PSE (formerly KSE). The subsets of corporate governance have been derived from various documents of SECP and ICAP. Researchers usually collect data from big firms which might be doing well because of profound resources and may not be essentially due to good governance. Therefore small firms have also been selected in the sample and similarly firms which exited the market have not been missed either. Enlistment on stock exchange has been taken as basis of sampling. In this research study micro data panel have been used which are unbalanced in nature. In this data each cross section observations have different time series. Therefore time series are more than one that is $T \neq 1$.

Description and Computation of Variables

Most of variables are in percentages, logs and indices. A few variables have dummy values. The Board Composition Index was calculated by taking percentages of actual number out of required number of directors in each category and summing all up. Similarly Board attendance Index was formed while institutional investors, first 5 percent block holders and directors' ownership were computed as percentages. Similarly the indicators of firm value for which earnings per share have been taken as proxy were computed through formulas. Some variables were computed as dummy due to their mutually exclusive dichotomous nature which included group association, presence of first 10% block holders, disclosure of board audit committee and disclosure of share ownership. Log of firm's age since inception was also computed. The other control variable was computed through formula.

Table 1. Variables

Variable Abbreviation	Variable Description
BDS	Board Size
CEOS	CEO & chairman separation
BCI	Index of executive ,non-executive & independent director
BAI	Board Attendance Index
F5BLOCK	% of Shares held by first five block holders out of total shares
II	% of shares held by institutional investors out of total shares
%F10BLOCK	% of Shares held by first ten block holders out of total shares
BLOCK10	existence of block ten -dummy(0,1)
DO	% of shares held by Directors out of total shares
GA	Group Association -Dummy(0,1)
BAC	Disclosure of Board Audit Committee-Dummy (0,1)
SO	Disclosure of Director Share Ownership -Dummy (0,1)
EPS	Earnings per Share
AGE	Age of the firm -number of years since incorporation(log)
MRISK	Market Risk

Net income after subtraction of dividend is the earning available to common shareholder which when divided by total number of shares gives earning per share while Beta of Regression in MM model is taken as proxy for market risk.

Model Specification & Methodology

The model described in terms of OLS equation is as such,

$$\begin{aligned} EPS_{it} = & \alpha_1 + \alpha_2 BDS_{it} + \alpha_3 BCI_{it} + \alpha_4 CEOS_{it} + \alpha_5 BAI_{it} \\ & + \alpha_6 F5BLOCK_{it} + \alpha_7 F10BLOCK_{it} + \alpha_8 DO_{it} + \alpha_9 II_{it} \\ & + \alpha_{10} GA_{it} + \alpha_{11} BAC_{it} + \alpha_{12} SO_{it} + \alpha_{13} MRISK_{it} \\ & + \alpha_{14} AGE_{it} + \epsilon_{it} \end{aligned}$$

Where dependent variable is earnings per share (EPS) while independent variables are components of corporate governance given in the table above with their abbreviations and descriptions. The market risk and age of firms are controlling variables while ϵ_{it} is error term in the above equation.

While reviewing literature on corporate governance especially the data analysis, it has been observed that researchers stumbled upon many econometric problems. The encountered problems are endogeneity, missing variables, sample selectivity bias and error in measurement of variables. However these problems are not faced in only estimation rather at every step of research and lead to wrong estimation results. If any research study is plagued by these problems then not only results of estimation but descriptive and diagnostics also may not turn out to be correct (Börsch-Supan & Köke, 2000). In order to resolve above mentioned issues diagnostic tests like White test, Pagan and Hausmann test were performed in this study and it was found that the most suitable technique is Generalized Method Of Moments (GMM) in order to tackle endogeneity occurring at the right hand side variables due to unobservable heterogeneity of the firms and also contributed by the structural reverse causality (Himmelberg et al., 1999). An example of reverse causality is that institutional investors make the firm perform better and therefore a firm that performs better can attract more institutional investors, now here the causality is reversed.

The second problem found in literature is regarding missing variable in a equation which leads to misspecification of the model. It is expected that some of the variables will not have linear relationship (Börsch-Supan & Köke, 2000). Theoretically all possible variables have been included like board structure, ownership, disclosure, earning per share, market risk and age of the firms. It has been assumed that some of the variables included may not be significant but still contribute to the overall significance of equation and therefore our model is not underspecified.

Data Analysis

The pre-estimation diagnostic tests performed in this study included VIF, Breusch Pagan test, White test, SK test, pooled OLS, OLS with random effect and fixed effect, FGLS, PCSE, Hausmann tests. A two step system GMM has been run with lagged independent variables as GMM instruments in STATA. The descriptive analysis was also carried out. The number of observations for Earnings per Share (EPS) is 1550. The minimum value of EPS observations collected is -222.82 while maximum value is 846.76. These values reflect on range of data which contains both negative and positive values. Mean value comes around 11.61208 which is central point in distribution. Its standard deviation is 44.19617 which is high enough to indicate the abnormality of data. Its skewness is 9.08821 which is well above 1 and indicate highly positively skewed data and kurtosis is 142.3112 which indicates the distribution of EPS is leptokurtic. Therefore descriptive of EPS suggested abnormality in data. It was revealed that there was no multicollinearity but the problem of endogeneity existed

Results & Discussion

When Generalized Method of Moments was run in STATA for previously mentioned equation, following estimates were obtained, which is given in the table below.

Table 2. Results

Independent Variables	Dependent Variable (EPS)
BDS	-1.530*** (-5.02)
BCI	5.014* (2.09)
CEOS	4.191*** (4.33)
BAI	18.90*** (3.55)
F5BLOCK	0.0953** (3.27)
F10BLOCK	-39.21*** (-10.61)
DO	-0.114*** (-4.68)

II	0.120*** (3.35)
GA	11.23*** (8.12)
BAC	4.372*** (4.02)
SO	-10.74** (-2.71)
AGE	10.72*** (4.99)
MRISK	4.855* (2.09)
CONSTANT	1.341 (0.21)
Arellano-Bond test ^b	[0.597]
Hansen-Sargan test ^c	[0.566]
Difference in Hansen Test ^d	[0.554]
Observations	1448

Notes:

a. We report two-step GMM results with corrected standard errors for a finite sample. The T-statistics are in parenthesis. *, ** and *** denote the 5%, 1% and 0.1% significance levels respectively. The dependent variable is the EPS. The model is estimated using the system-GMM estimator described in Blundell and Bond (1998). The lags of all explanatory variables have been used as instruments of the GMM in equation.

b. The p-value from Arellano-Bond test for the null hypothesis of no AR (2) serial correlation of the residuals.

c. The p-value from the Hansen-Sargan test for the null hypothesis of valid instruments.

d. Difference in Hansen Test

The results indicate that large Board Size, First 10 % Block holders and Directors' Ownership negatively impact earning per share at 99.99% confidence level. Board composition index and market risk both have positive impact at 95% while board attendance index, CEO Chairman separation, First 5 % block holders, institutional investors, group association, disclosure of board audit committee and age contribute towards higher earnings per share and the same can be claimed at 99.99% confidence level. Share ownership when disclosed negatively impacts

earnings per share. The number of observations were 1448 while Arellano Bond test value is 0.597 indicating no autocorrelation and Hansen Sargan test value 0.566 indicates that there's no over identifying restrictions in the model and the instruments are valid. Difference in Hansen test value is 0.554 therefore the model has been equally identified. Results show that by increasing one unit of Board there can be a decrease of 1.530 units in Earning per Share. The largest negative impact has been observed for First Ten percent block holders where just one unit increase can bring 39.21 units decrease in EPS, keeping rest everything constant. The smallest positive impact has been depicted by concentration of ownership by first five percent block holders where its one unit increase can bring about a 0.0953unit change in shareholders' value. The research has identified governance practices as either EPS booster or EPS damper.

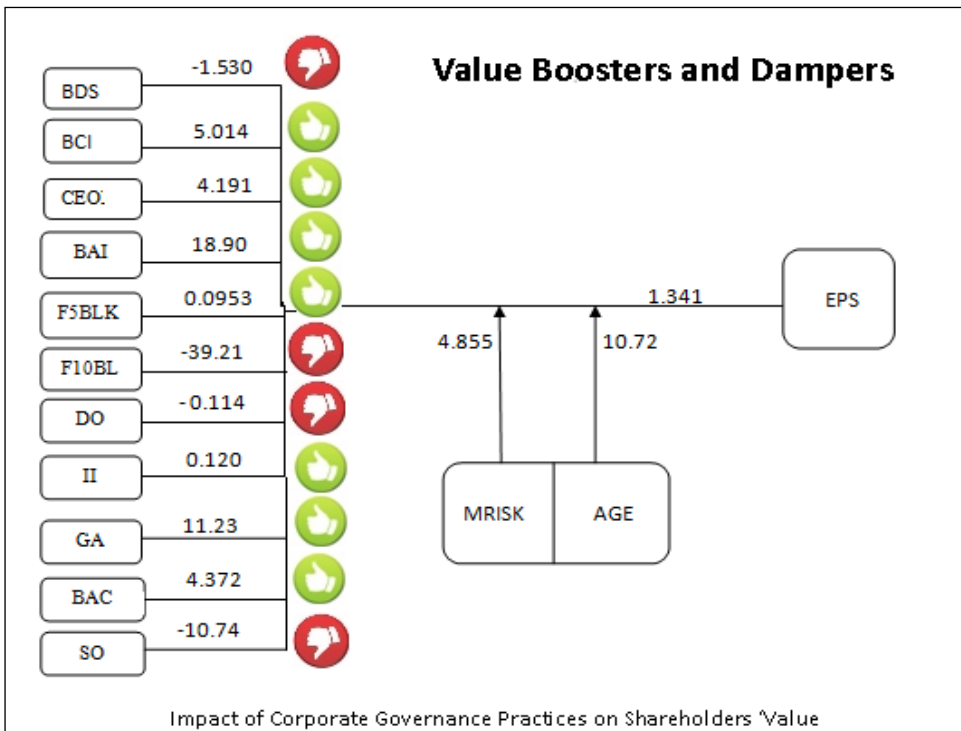
Table 3. EPS Dampers & Boosters

EPS Dampers	EPS Boosters
High Directors' Ownership	High Board Composition Index
First 10% or more Block holders	Board Attendance of All Directors
Disclosure of Directors' Ownership	Separation of CEO from Chairman Role
Large Board Size	High Institutional Investors holding
	Presence of Group Association
	Presence Board Audit Committee
	Presence of First 5% Block holders

Pro entrenchment have negative significant relationship with earnings per share and are thus value dampers while non-entrenchment practices positively affect rather boost earnings per share as per T-stats and p-values estimates obtained as a result of running generalized method of moments. The coefficients are small as reported by most corporate governance studies. It is evident that all corporate governance variables are entwined and inter-related which made data analysis complicated. Institutional investors are not sometimes efficient as they feel that its responsibility of independent directors to monitor performance. In other words, board independence makes them less efficient. On the other hand, independent directors make audit committee more efficient. Executive directors may not be effective due to their subordination to CEO. In case of Chairman and CEO role

duality, executive directors are not efficient while otherwise they might tend to make entrenchments and may be involved in tunneling.

Figure 1. Impact of CG on Shareholders Value



From results it is obvious that institutional investors closely monitor performance and consists of business corporate rather than venture capitalists and they are also long term shareholders who take keen interest in the matters of firm. However this shareholder activism has still not reached its full potential where it can be termed as fiduciary capitalism.

Similarly first ten percent block shareholders might be venture capitalists that serve their interests or are simply indifferent firms. Large boards are ineffective and directionless. Non-duality of CEO & chairman role contributes in enhancing firm's value. Group association makes business opportunities and resources available to affiliated firms. Similarly, due to board independence audit committees become effective while ownership concentration does affect earnings per share but similar to board size the relationship is not linear but moves along an inverse U shaped. Very small boards and ownership concentration are not effective while a reasonable size does make a dent. Again excessively large size would render boards and concentrated ownership useless. One fact that is clear from results is that minority shareholders must be given protection. If corporate

governance practices are seen as value boosters or dampers for the worse and not just as a method of running organizations, the very purpose of having such mechanism in place can be met with and all agency problems can be resolved. Such categorization may not be difficult to achieve but its generalization would certainly be problematic as boosters and dampers might vary with the varying context. Here comes the role of researcher to find new theories, which may be able to explain these variations. Any categorization made should not be spurious and must be grounded in theories of organization and governance in order to benefit in a better way from governance practices.

Conclusion

Results indicate board size, first 10 Block holders, director ownership and disclosure of ownerships adversely impact the earnings per share. These pro-entrenchment acts suppress EPS in Pakistani firms. The results are well justified according to Entrenchment Theory of Corporate Governance. One other probable reason could be firms' earnings management is either inefficient or aimed at tax and dividend evasion rather than market performance. While the study has good reasons to understand that CEO Chairman role separation, board attendance index, board composition index, institutional investors, First 5 block holders, group association, age and market risk cast significant positive effect on earnings per share in firms listed on PSE. Hence according to agency theory and stewardship theory the agents & stewards strive to enhance shareholders value.

Policy Implications & Recommendations

Research suggests that counter-entrenchment policies may be adopted to increase firm's value and profitability while the following the rest best practices of corporate governance may be emphasized in a more rigorous manner aimed at enhancing shareholders' value. This study highlights the negative consequences of large block holders on Earning per share which in turn entails protection of minority shareholders. Also detailed disclosure of directors' ownership may scare away the potential investors therefore directors' ownership may be curtailed. The future researches may employ entrenchment policies and study their impact on earnings management.

In Pakistan corporate governance is seen more as a regulatory intervention and a compliance obligation rather than a sovereign choice made on the basis of consequences it generates. Firms perceive governance practices as a formality to be dispensed with. There is high need that these are propagated as value boosters and dampers so that the best governance practices can be picked up and adopted by firms. New ideas and theories must be propagated so that corporate governance

is not seen as an ordinary matter of running a business but a decision choice of enhancing share holders' value.

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